

Message Text

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PAGE 01 ISLAMA 00193 01 OF 02 051156Z
ACTION NEA-10

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-05 H-01 INR-07
L-03 NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15
USIA-06 AID-05 COME-00 EB-08 FRB-03 TRSE-00
XMB-02 OPIC-03 LAB-04 SIL-01 OMB-01 AGRE-00 /084 W
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P 051030Z JAN 78
FM AMEMBASSY ISLAMABAD
TO SECSTATE WASHDC PRIORITY 5316

LIMITED OFFICIAL USE SECTION 1 OF 2 ISLAMABAD 0193

E.O. 11652: N/A
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SUBJECT: GOP ACTS TO CUT BUDGET DEFICIT

REF: ISLAMABAD 0076

1. BEGIN SUMMARY: IN A WIDE RANGING PRESS CONFERENCE ON NEW YEAR'S DAY (REFTEL), GENERAL ZIA ANNOUNCED A FISCAL PACKAGE DESIGNED TO CURTAIL THE BUDGET DEFICIT WHICH WOULD OTHERWISE HAVE RISEN TO TWICE THE AMOUNT ESTIMATED WHEN THE BUDGET WAS ISSUED IN JUNE. THE ANNOUNCEMENT FOCUSSED ON INCREASING REVENUES VIA A VARIETY OF TAXES RATHER THAN DECREASING SPENDING; GENERAL ZIA HAD EARLIER ANNOUNCED A 5 PERCENT ORDINARY BUDGET CUT (ISLAMABAD 12400) WHICH SAVED THE GOVERNMENT \$45 MILLION (ALL FIGURES IN US DOLLARS AT \$1 EQUALS 9.9 RS.). TAKEN AS A WHOLE, THE NEW YEAR FISCAL PACKAGE PLUS EARLIER MEASURES SHOULD LIMIT THE INFLATIONARY IMPACT OF THE DEFICIT BY KEEPING IT AT THE LEVEL ENVISAGED IN JUNE. THE NEW MEASURES PLACE MOST OF THE BURDEN FOR INCREASING GOVERNMENT RECEIPTS ON IMPORTERS OF CERTAIN TYPES OF MACHINERY AND UPPER INCOME CLASSES WHILE PROVIDING A SMALL MEASURE TO TAX RELIEF MAINLY AFFECTING LOW INCOME

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PAGE 02 ISLAMA 00193 01 OF 02 051156Z

GROUPS. ALTHOUGH THE TARIFF INCREASE MAY BE AT THE EXPENSE OF SOME INDUSTRIAL GROWTH AND WILL NOT BE POPULAR WITH MANUFACTURERS, ZIA'S PREVIOUS MOVES FAVORING THE PRIVATE SECTOR, E.G. DENATIONALIZATIONS AND ASSISTANCE TO THE TEXTILE INDUSTRY, HAVE PRESUMABLY GIVEN HIM SOME POLITICAL CAPITAL HE CAN NOW AFFORD TO SPEND. WORKING WITHIN A TIGHT BUDGET

WITH A NEED TO INCREASE TAXES OVERALL, THE PACKAGE DEMONSTRATES A VISIBLE EFFORT TO REDUCE THE TAX BURDEN SLIGHTLY ON LOW INCOME GROUPS WHICH FEEL THEMSELVES HARD HIT BY INFLATION BY CUTTING TAXES ON BICYCLES, TOBACCO, AND ON THE PROCESSING OF COTTON SEED OIL. ALSO BY INCREASING THE IRRIGATION RATES, ZIA IS BEING RESPONSIVE TO CRITICS WHO HAVE LONG ADVOCATED REMOVING THE IRRIGATION AND SIMILAR SUBSIDIES. END SUMMARY.

2. IN HIS JANUARY 1 PRESS CONFERENCE, GENERAL ZIA ANNOUNCED A NUMBER OF REVENUE MEASURES DESIGNED TO REDUCE THE PFY 78 BUDGET DEFICIT TO THE LEVEL ENVISAGED IN JUNE. THE BUDGET ORIGINALLY PROJECTED FEDERAL GOVERNMENT BORROWING FROM THE CENTRAL BANK AT ABOUT \$149 MILLION TO COVER THE DEFICIT IN THE BUDGET FOR PFY 78 (JULY 1 JUNE 39). THE BUDGETERS CALCULATED THAT A DEFICIT OF THIS AMOUNT WOULD BE WITHIN ACCEPTABLE INFLATIONARY PARAMETERS. SINCE JUNE, A NUMBER OF EVENTS HAVE OCCURRED TO BOTH INCREASE GOVERNMENT EXPENDITURES AND REDUCE GOVERNMENT RECEIPTS.

3. ON THE EXPENDITURE SIDE, THREE FACTORS CONTRIBUTED TO A RISE OF \$123 MILLION IN SPENDING OVER THE ORIGINAL BUDGET ESTIMATES: INCREASED OIL PRICES (PLUS LIMITED OFFICIAL USE

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PAGE 03 ISLAMA 00193 01 OF 02 051156Z

\$19 MILLION), SUBSIDIES CAUSED BY INCREASED WHEAT IMPORTS (PLUS \$27 MILLION), AND COST OVERRUNS ON TARBELA DAM (PLUS \$77 MILLION).

4. GOVERNMENT REVENUES FROM EXPORT DUTIES WERE EXPECTED TO FALL BY ABOUT \$121 MILLION FROM THE EARLIER ESTIMATE BECAUSE THE WORLD PRICE FOR COTTON FELL FROM ITS JUNE LEVEL OF ABOUT 80 PER POUND TO AROUND 50 CENTS.

5. THE RESULTING INCREASE OF \$244 MILLION IN THE BUDGET DEFICIT WOULD HAVE BEEN PARTLY OFFSET BY THE 5 PERCENT ACROSS THE BOARD BUDGET CUT ANNOUNCED IN NOVEMBER AND BY INCREASED CUSTOMS RECEIPTS ARISING FROM HIGHER PRICES OF IMPORTED CIGARETTES AND A HIGHER DUTY FOR TEA (ISLAMABAD 10793). HOWEVER, THE OVERALL DEFICIT INCREASE WOULD STILL AMOUNT TO \$158 MILLION WHICH WOULD HAVE BROUGHT THE NEW DEFICIT TO ABOUT \$307 MILLION.

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PAGE 01 ISLAMA 00193 02 OF 02 051159Z
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LIMITED OFFICIAL USE SECTION 2 OF 2 ISLAMABAD 0193

6. THE CUSTOMS, EXCISE AND INCOME TAX MEASURES
ANNOUNCED BY GENERAL ZIA ON JANUARY 1 ARE DESIGNED TO
RESTORE THE ORIGINAL DEFICIT. THESE MEASURES PLUS AN
INCREASE IN IRRIGATION RATES ARE EXPECTED TO NET
ABOUT \$175 MILLION, THE LEVEL OF DEFICIT FINANCING
THEN BECOMES ABOUT \$139 MILLION.

7. EXCISE TAXES WERE REMOVED ON UNMANUFACTURED TOBACCO,
EXTRACTION OF COTTON SEED OIL, BICYCLES,
WOOLEN YARN, TOOTHPASTE AND TOOTHPOWDER, CREAMS AND
POLISHES FOR FOOTWEAR, RUBBER AND PLASTIC GOODS,
1.5 VOLT BATTERIES AND CERTAIN TYPES OF WRITING
PAPER. THE TOTAL COST TO THE GOP WAS ESTIMATED AT
\$7 MILLION. THE MOST IMPORTANT EXEMPTIONS WERE
THOSE FOR UNMANUFACTURED TOBACCO, USED MAINLY BY
THE RURAL POPULATION, EXTRACTION OF COTTON SEED OIL,
A MAJOR INPUT TO THE GHEE INDUSTRY AND BICYCLES
-THE MOST WIDELY USED MODE OF TRANSPORTATION IN
PAKISTAN. THE BICYCLES REBATE, ANNOUNCED AT \$15,
COULD REDUCE THE RETAIL PRICE OF A BICYCLE BY 30
PERCENT.

8. CUSTOMS DUTIES WERE INCREASED ON MANMADE YARN
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PAGE 02 ISLAMA 00193 02 OF 02 051159Z

(PLUS \$6 MILLION), CAR PARTS AND CARS WITH ENGINES
OVER 1000CC CAPACITY (PLUS \$7 MILLION), AIR

CONDITIONERS (PLUS \$1 MILLION), REFRIGERATORS (PLUS \$5 MILLION), COLOR TELEVISION SETS (PLUS \$1 MILLION, FERROUS AND NON-FERROUS METALS AND PRODUCTS (\$12 MILLION), ARTIFICIAL RESINS AND PLASTIC MATERIALS (\$3 MILLION), RUBBER AND ARTICLES THEREOF (PLUS \$1 MILLION), WRAPPING AND PACKAGING PAPER (\$5 MILLION), BUTTER \$1 MILLION), AND A NET INCREASE OF \$30 MILLION RESULTING FROM THE COMBINATION OF INCREASED DUTIES ON IMPORTED MACHINERY WHICH COMPETES WITH LOCALLY MANUFACTURED MACHINES AND A REBATE ON RAW MATERIALS IMPORTED BY MACHINERY MAKERS. THE ONLY DECREASE IN CUSTOMS DUTY WAS FOR SECOND HAND CLOTHES (MINUS \$1 MILLION) WHICH ARE PURCHASED BY LOW INCOME GROUPS. THE MAIN REVENUE GAIN WAS IN MACHINERY DUTIES WHICH ZIA PORTRAYED AS A PROTECTION MEASURE FOR LOCAL INDUSTRY. HE IS RIGHT; THIS WILL FURTHER PROTECT AN ALREADY INEFFICIENT INDUSTRY.

9. A SURCHARGE OF 10 PERCENT WILL BE LEVIED ON PERSONAL INCOME TAX, WHICH PARTIALLY OFFSETS THE 10 PERCENT REDUCTION IN THE MAXIMUM MARGINAL RATE MADE BY THE PRVIOUS GOVERNMENT AND IS EXPECTED TO INCREASE TAX RECEIPTS BY \$13.5 MILLION.

10. THE GOP HOPES TO GAIN \$100 MILLION, THE LARGEST SINGLE ITEM IN THE NEW FISCAL PACKAGE, THROUGH IMPROVED ADMINISTRATION OF THE TAX LAWS. ALTHOUGH THIS SEEMS OPTIMISTIC A GOP BUDGET OFFICIAL TOLD US THAT \$40 MILLION HAS ALREADY BEEN COLLECTED.

11. BHUTTO INSTITUTED AN ARRICULTURAL INCOME TAX LIMITED OFFICIAL USE

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PAGE 03 ISLAMA 00193 02 OF 02 051159Z

IN THE LAST DAYS OF HIS ADMINISTRATION AND LAND-OWNERS HAVE BEEN FIGHTING FOR ITS REMOVAL EVER SINCE. ZIA APPARENTLY DID NOT WANT TO ENTER THE FRAY AT THIS TIME AND ANNOUNCED THAT THE INCOME TAX WOULD BE DEFERRED UNTIL ALL THE ARGUMENTS COULD BE SORTED OUT. HOWEVER, HE DID REVIVE THE AGRICULTURAL LAND REVENUE, WHICH WAS USED PRIOR TO THE AGRI-CULTURAL INCOME TAX, AND DOUBLED TH RATE. THE GOP EXPECTS THE TWO ACTIONS WILL RESULT IN NO NET CHANGE TO THE BUDGET.

1. IN A BUDGETARY MEASURE THAT IS BOUND TO BE POLITICALLY UNPOPULAR, ZIA ANNOUNCED A 25 PERCENT INCREASE IN IRRIGATION RATES SAYING THAT THE PRESENT RATE STRUCTURE WAS NOT COVERING THE COSTS OF IRRIGATION. THE NEW RATES WILL INCREASE GOVERNMENT RECEIPTS BY \$5 MILLION.

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